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Supreme Court of the United States

OCTOBER TERM, 1997

MERRILL, LYNCH, PIERCE, FENNER & SMITH INCORPORATED, PAINEWEBBER INCORPORATED and DEAN WITTER REYNOLDS INC.,

Petitioners,

—v.—

JEFFREY PHILLIP KRAVITZ, GLORIA BINDER and BRUCE ZAKHEIM IRA FBO BRUCE ZAKHEIM,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF AMICI CURIAE SECURITIES INDUSTRY ASSOCIATION & SECURITY TRADERS ASSOCIATION, INC. IN SUPPORT OF PETITIONERS' WRIT OF CERTIORARI

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INTEREST OF THE AMICI CURIAE[1]

The Securities Industry Association ("SIA") is the trade association representing the interests of nearly 800 securities firms, employing over 380,000 individuals. SIA members - including broker-dealers, mutual fund complexes and investment banks - are active in all aspects of corporate and public finance. The U.S. securities industry manages the accounts of more than 50 million investors directly and generates $270 billion of revenues in the U.S. economy.

The Security Traders Association ("STA") is the only trade association in the securities industry that represents *individual* practitioners, many of whom are direct participants in the National Association of Securities Dealers Automated Quotation system (the "NASDAQ" market). As "market makers," many STA members share the responsibility of maintaining liquid and transparent markets in NASDAQ-listed stocks. Among the STA's 7,500 members in Canada, France, and the United States are traders and registered representatives from broker-dealers, institutions, and specialist firms.

Together, *Amici Curiae* represent a significant portion of the market professionals affected by the ruling below. *Amici* are vitally concerned that the Third Circuit's opinion in this case will undermine the certainty that is essential for the efficient execution of well over one billion transactions annually on the NASDAQ market. That certainty will be eviscerated if reliance on then-current regulatory and industry standards for execution of retail

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[1] Letters of consent to the submission of this brief have been filed with the Clerk of the Court pursuant to Rule 37.3. Pursuant to Rule 37.6, counsel for *amici* states that no counsel for a party authored this brief in whole or in part and no person, other than *amici* or their counsel made a monetary contribution to the preparation of this brief.

transactions can be displaced, years after the fact, by a single appeals court's application of a generic antifraud proscription. The Third Circuit's ruling could produce a flood of litigation that would impair over 1.6 billion transactions annually based on its second-guessing industry-wide applications of then-existing technology.

The SIA and STA are familiar with the issues raised in the Petition for a Writ of Certiorari and believe that their participation in this *amici curiae* brief would be helpful to the Court. *Amici* submit that the District Court correctly rejected plaintiffs' claims and that the Third Circuit's *en banc* decision should be reversed.

SUMMARY OF ARGUMENT

Certainty and predictability are critical to the securities markets. The tremendous trading volume common to today's markets requires precision as to the obligations of all parties to these transactions. The issue presented to this Court is whether, as a matter of law, petitioners could commit securities "fraud" by relying on the national best bid and offer price ("NBBO") - in accordance with regulatory pronouncements and industry-wide practice - in the execution of small retail transactions on the NASDAQ market during the class period. The Third Circuit, *en banc*, determined that the mere *possibility* of the availability of alternative quotes precludes summary judgment on these issues. *Amici* advance two core arguments that compel the need for this Court's review of the Third Circuit's decision.

First, given the rapid pace of change in information technology affecting the securities markets, it is critical that market participants be able to rely on existing regulatory guidance in fulfilling their "duty of best execution." The extent of that change becomes apparent in contrasting the significant advances during the 1992-94 class period and in the interim period leading to the Third Circuit's ruling earlier this year. Capabilities now taken for granted were in their infancy as recently as the class

period. For example, during the class period, the Securities and Exchange Commission's ("SEC" or "Commission") electronic filing system, EDGAR (Electronic Data Gathering, Analysis, and Retrieval) was not yet fully operational. The number of U.S. electronic mail users more than doubled during the class period alone and, by the time the Third Circuit issued its opinion, doubled again to 55 million users.

The translation of these technological changes into marketplace obligations must be left to the regulatory agencies overseeing the marketplace on a "real time" basis. As this Court has recognized repeatedly, these regulatory bodies, with their unique and specialized expertise, are best equipped to determine when market professionals must utilize technological improvements. These capabilities are constantly evolving. Through a series of releases, no-action letters[2] and other public pronouncements, the SEC and other regulatory bodies have delineated carefully the extent to which market participants can avail themselves of new technology. It is telling that, as part of this process, after input from market participants, the SEC issued new regulations after the class period concerning whether sole reliance on the NBBO price satisfied broker-dealer obligations to customers. The Third Circuit, at the behest of private litigants, has usurped the role properly accorded to an expert agency and attempted to restate regulatory standards (without the safeguards that accompany SEC rulemaking).

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[2] "A no action letter provides analysis of a specific transaction; interpretative letters provide an analysis of a specific statute, rule, or regulation in the context of an actual fact situation. No-Action and interpretative letters are issued by the Commission staff, not the full Commission, and do not bind the Commission." 1 Louis Loss & Joel Seligman, Securities Regulation 532-33 n.29 (3d ed. 1998).

Second, the breadth of the Third Circuit's application of an implied right of action under a generic securities antifraud provision - Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) - conflicts with the rulings of this Court and others regarding the plain language of the federal securities laws and the proper scope of implied rights and remedies under Section 10(b). Congress has made clear, and this Court repeatedly has stressed, that the goals of the securities laws must be balanced with the need for certainty that is critical to the operation of the securities markets.

The Third Circuit's *en banc* reversal of the District Court's opinion turned on a determination that the obligations of broker-dealers in executing small orders for customers had evolved, by the class period, because of the Third Circuit's *belief* that "both technology and over-the-counter markets had developed to the point where it was feasible to maximize the economic benefit to the client by taking advantage of better prices than the NBBO." *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 272 (3d Cir. 1998) (*en banc*). The Third Circuit's opinion suggests that implied liability for a vast number of securities transactions should rest on a trier of fact's determination of the proper legal standard, which is dependent on the jury's determination of what is "feasible" under a best execution obligation that itself is undefined. Making these determinations well after the fact is inconsistent with the scope of implied remedies under Section 10(b) and the certainty that is essential to the marketplace.

I. THIS COURT HAS RECOGNIZED THAT CERTAINTY IS INTEGRAL TO THE OPERATION OF THE SECURITIES MARKETS

As Section 10(b) provides no express private right of action, the need for certainty has guided this Court's interpretation regarding the scope of any liability in an implied action under that provision. *See, e.g., Central Bank v. First Interstate Bank*, 511 U.S. 164, 188 (1994) (stressing that certainty and predictability are crucial to the securities markets). In *Central Bank*, a purchaser of public improvement bonds brought suit under Section 10(b) and Rule 10b-5 thereunder, alleging that the petitioner bank, by failing to obtain an independent real estate appraisal, aided and abetted a fraud. *Id.* at 167-69. Observing that the plain language of the statute did not confer a private litigant with the right to sue under an aiding and abetting theory, this Court rejected the respondent's claim and reversed. *Id.* at 191. The Court noted that extending liability under 17 C.F.R. § 240.10b-5 ("Rule 10b-5") to aiders and abettors could be a disservice to the public as the expenses associated with protracted litigation can create uncertainty in the marketplace and increase the costs of raising capital. *Id.* at 189.[3]

Central Bank reiterated this Court's long-standing concern in its Section 10(b) jurisprudence regarding the need by

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[3] Congress reaffirmed this judgment in 1995, when it adopted the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 ("PSLRA"). The PSLRA added Section 20(f) to the Exchange Act, expressly authorizing the *Commission* to initiate proceedings against parties who aid and abet securities violations. In doing so, Congress overruled this Court's *Central Bank* decision insofar as it might apply to the SEC, but left intact this Court's holding, and its reasoning, that denied such an action to private litigants.

market participants for certainty and predictability. *See, e.g., Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 357 (1991) (holding that a claim under Section 10(b) is governed by the statute of limitations in the Securities Act of 1933 and the Exchange Act because "the federal interests in predictability and judicial economy counsel the adoption of one source"); *Dirks v. SEC*, 463 U.S. 646, 659 (1983) ("Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed."); *Chiarella v. United States*, 445 U.S. 222, 235 & n.20 (1980) (noting that broad construction of Section 10(b) would be "inconsistent with the careful plan that Congress has enacted for regulation of the securities markets").[4]

Following the lead of this Court, lower courts too have cited the need for stability and certainty in the marketplace in reaching decisions concerning federal securities laws. *See, e.g., Banca Cremi v. Alex. Brown & Sons*, 132 F.3d 1017, 1035 (4th Cir. 1997) (holding that plaintiff failed to show that broker committed securities fraud by charging excessive markups and not informing customer of these charges because, in part, the SEC "abandoned an effort to administratively require such

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[4] This Court's emphasis on the need for certainty in the securities markets is not limited to cases arising under Section 10(b). *See, e.g., Gustafson v. Alloyd Co.*, 513 U.S. 561, 578 (1995) (noting that extension of liability under Section 12(2) of the Securities Act would "impair[] the stability of past transactions"); *Pinter v. Dahl*, 486 U.S. 622, 652 (1988) (noting, in case arising under Section 12(1) of the Securities Act of 1933, 15 U.S.C. § 12, that the securities markets are an "area that demands certainty and predictability"); *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 11-12 (1985) (rejecting broad interpretation of Section 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 14, because it would inject uncertainty into tender offer process).

disclosures"); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226-27 (10th Cir. 1996) (citing *Central Bank* for the proposition that "certainty and predictability are crucial to securities markets."); *accord Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996) (overturning censure of securities broker because SEC's interpretation of 17 C.F.R. § 240.15c3-3(e) created "substantial uncertainty"). *See also United States v. Cochran*, 109 F.3d 660, 665-67 (10th Cir. 1997) (reversing conviction where conduct was not expressly prohibited).

The need for certainty and predictability has become more acute with the increase in the volume of trading in the NASDAQ market. From more than 332 million trades in 1990, NASDAQ saw its volume increase to more than 1.6 billion in 1997. *See NASDAQ Total Volume*, IDD Information Service, May 28, 1998, *available in* LEXIS, Quote Library, HIST File. The sheer volume of these transactions underscores that judicial fidelity to certainty in the securities markets is well placed.

II. ADAPTING REGULATORY REQUIREMENTS TO RAPIDLY CHANGING INFORMATION TECHNOLOGY SHOULD BE THE PROVINCE OF EXPERT REGULATORY BODIES

Nowhere is the need for certainty more pronounced than in addressing the application of burgeoning information technology capabilities to the securities markets. As the District Court below observed, "[i]n a modern market that involves both rapid evolution of technology and large-scale expansion of the use of that technology, a state of constant and sometimes radical change may, in one sense, represent the 'status quo.'" *In re Merrill Lynch Sec. Litig.*, 911 F. Supp. 754, 772 (D.N.J. 1995). The SEC, in particular, is engaged in an ongoing deliberative process to adapt its implementation of New Deal-era statutes to this rapidly-changing environment. Federal courts, acting without the benefit of notice and comment that is required to accompany agency rulemaking, should be loathe to adopt new regulatory

requirements on an *ad hoc* basis in the place of the expert regulatory agency's guidance on such issues.

A. The Capability of Information Technology Has Grown Rapidly During and Since the Class Period

Since the issue of best execution is framed as an evolving legal standard, it is important to place in context the vast changes in information technology available to the securities market. Over the last decade, the capability and availability of information technology has grown exponentially. It is well established that, in the computer industry, computing power doubles every 18 months, *see* Pam Woodall, *Survey of the World Economy (1): The Hitchhiker's Guide to Cybernomics - New Technology and Globalisation are Changing the World*, Economist, Sept. 28, 1996, *available in* 1996 WL 11247312, while the price of computers declines at an annual rate of twenty percent. *See* Robert Adams, *Social Contexts of Technology (Technology and the Rest of Culture)*, Social Research, Sept. 22, 1997, *available in* 1997 WL 11171193. For example, in 1988, the average price of a personal computer equipped with a CD-ROM drive was approximately $4,500. *See* Ralph T. King, *The Price is Right: That's Why the Purchases of Multimedia Machines Have Begun to Take Off*, Wall St. J., Mar. 21, 1994, *available in* 1994 WL-WSJ 300704. By 1992, the price of that same type of personal computer had dropped to $2,500, and a year later, the average price had fallen to $2,000. As prices dropped, sales rose from 87,000 units in 1992 to 1.7 million units in 1993. *Id.*

Similarly, the price of larger-scale computing technology, like that used in large brokerage firms, also dropped dramatically in the late 1980s and 1990s. The power of a mainframe computer as measured in MIPS - a computer's ability to process one million pieces of information per second - has dropped from $400,000 per MIP in 1980, to $117,000 in 1989, to $34,000 in 1994. *See The Mainframe Bytes Back*, U.S. News & World Rep., Oct. 17, 1994, at 68. Not only is today's $2000 laptop computer many

times more powerful than a $10 million mainframe computer was in the mid-1970's, *Survey of the World Economy*, but "[a]t one one-hundredth of one percent of what comparable computer power cost a quarter-century ago, the amount of it that now can be carried in a shirt pocket is probably comparable to what was available to NASA itself in first venturing to the moon." *Social Contexts*.

As a result of the drop in computing prices and the availability of faster and more powerful machines at lower prices, the use of information services has grown dramatically. For instance, the use of electronic mail through the Internet, which was developing during the class period, is now a vital tool for many businesses.[5] In 1992 - the first year of the class period - only five million Americans used electronic mail, sending approximately 10 million messages a day. Jon G. Auerbach, *Getting the Message: As E-mail Booms, It Is Changing the Frequency*, Wall St. J., June 16, 1997, *available in* 1997 WL-WSJ 2424254. By the end of the class period in 1994, 13 million Americans used electronic mail, sending approximately 28 million messages daily. *Id.* In 1997, the year prior to the Third Circuit's opinion in this case, 55 million Americans used e-mail, sending approximately 150 million messages a day. *Id.*

These changes have improved dramatically investor access to key information. One of the most important examples

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[5] The Internet is a worldwide network of interconnected computers that allows a person using a computer linked to the network to communicate with other network users. One means of communicating through the Internet is by electronic mail ("e-mail"). *See Reno v. ACLU*, 117 S. Ct. 2329, 2334 (1997). E-mail enables a person to send an electronic message, much like a letter sent through the regular mails, to another person who has a computer connected to the same network. *See id.* at 2335.

can be seen in the SEC's EDGAR system on which most public companies now submit their filings. Since EDGAR became fully operational in 1996, these filings have been available through the SEC's site on the World Wide Web.[6] SEC, *Report to Congress: The Impact of Recent Technological Advances on the Securities Markets* (1997) [hereinafter *Report to Congress*]. This site is viewed an average of 500,000 times a day. *See id.* The SEC's utilization of information technology has altered fundamentally the market it must regulate.

B. Securities Regulators Must Strike a Balance in Adapting Existing Rules to New Information Technology

Information technology innovations affect all aspects of the securities markets. Each innovation generates a myriad of untested issues under the federal securities laws. Regulators must strike a balance between fostering the efficiency afforded by improving technology while upholding the policy objectives underlying long-standing regulatory requirements. This regulatory balancing is evident in virtually every aspect of the securities regulatory system:

- **Prospectus Delivery Requirements.** Rules promulgated under the Securities Act impose certain document delivery requirements to fulfill disclosure obligations in a

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[6] The World Wide Web is a segment of the Internet through which users may search for and retrieve information stored in remote computers. *See Reno*, 117 S. Ct. at 2335. Some of the information contained on the world wide web takes the form of "web pages" or "web sites," which consist of sets of information, typically including images and "links" to other web sites. Each web page has a unique identifying address, much like a telephone number. *See id.*

securities offering. *See, e.g.*, 17 C.F.R. § 230.174. A prospectus detailing material information regarding the offering must be delivered to purchasers prior to or at the same time the purchasers are provided with a sales confirmation. *See* 17 C.F.R. §§ 230.153, 230.153a, 230.153b. The proliferation of e-mail affords companies the capacity to expedite the document delivery process at a fraction of the cost. At the same time, electronic delivery does not allow issuers to meet traditional formatting requirements - such as bold-face type or the use of red ink for portions of preliminary prospectuses - developed when paper was the only available medium for distribution. *See* 17 C.F.R. § 230.420. The SEC has sanctioned electronic delivery in situations in which investors are given adequate notice, the document is reasonably available to investors and the system generates some reasonable assurance that the investor received the information. General guidelines allow for reasonable attempts to deliver the same information in both electronic and paper formats. *See* Use of Electronic Media for Delivery Purposes, Securities Act Release No. 7233, Exchange Act Release No. 36,345, 60 Fed. Reg. 53,468, 1995 SEC LEXIS 2662 (Oct. 6, 1995) [hereinafter *October 1995 Release*]. Further deliberation and review of comment letters culminated in the adoption of several amendments to SEC regulations. *See* Use of Electronic Media for Delivery Purposes, Securities Act Release No. 7289, Exchange Act Release No. 37,183, 61 Fed. Reg. 24,652, 1996 SEC LEXIS 1298 (May 9, 1996).

• **Bulletin Board Marketplaces.** Several issuers have found in Internet technology the capacity to create an on-line market for their securities. The SEC was compelled to face the question of whether such markets should be required to register as a "national securities exchange" under Section 6 of the Exchange Act, 15 U.S.C. § 78f. In a series of no-action letters, the Commission's staff has indicated that such registration (and other potential regulatory requirements) could be avoided if certain safeguards were built into the marketplace. These safeguards included (i) restrictions regarding the handling of investor funds, (ii) disclosure to investors regarding the risks of investment in

illiquid securities and (iii) disclosure of broker-dealer registration requirements to investors simultaneously posting buy and sell quotations. *See, e.g.*, *Spring Street Brewing Co.*, SEC No-Action Letter, [1996-1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,201 (Apr. 17, 1996); *Real Goods Trading Corporation*, SEC No-Action Letter [1996 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,226 (June 24, 1996).

• **Internet "Roadshows."** A roadshow is a sales effort led by an issuer's senior management and its underwriter, usually before the registration statement becomes effective, *i.e.*, the day the SEC staff approves the registration. *See* 1 Loss & Seligman, *supra* note 2, at 341. Although Section 5 of the Securities Act, 15 U.S.C. § 77e, bars contracts for sale of securities during the period the registration statement is awaiting SEC approval, oral offers or written ones by means of a prospectus meeting the requirements of Section 10 of the Securities Act, 15 U.S.C. § 77j are permissible. *See id.* at 466-71. The roadshow audience typically is limited to a relatively small group of institutional investors. *See id.* at 341. Advances in information technology have created the opportunity for investors now to view the roadshow on a designated web site at their convenience. One potential impediment rests in the concern that the transmission of the roadshow through the Internet might itself be considered a "prospectus." The Commission's staff has provided no-action guidance that it would not assert such a claim based on certain representations made by sponsors of services offering Internet roadshows. Given the inability to ensure that each person present at electronic roadshows was handed a copy of the prospectus, the sponsors indicated that investors would have access to the preliminary prospectus and would be reminded that detailed financial information regarding the issuer can be found in the prospectus. *See, e.g.*, *Private Financial Network*, SEC No-Action Letter [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,332 (Mar. 12, 1997); *Net Roadshow, Inc.*, SEC No-Action Letter [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,367 (Sept. 7, 1997).

• **Corporate "Web Site" Communications.** Corporate sites on the world wide web are an important disclosure tool. Among other issues, the Commission has been required to refine its views regarding potential liability for such disclosure. For example, the SEC's staff has expressed its view that a mere reference to a corporate web site in a registration statement does not serve to incorporate all of the contents of the web site into the registration statement (and expose the contents to the heightened liability standards under the Securities Act). *See, e.g., ITT Corp.*, SEC No-Action Letter, 1996 SEC No-Act. LEXIS 895 (Dec. 6, 1996); *BG&E Corp.*, SEC No-Action Letter, 1997 No-Act. LEXIS 14 (Jan. 6, 1997).

• **Proxy Solicitations.** Corporations have taken advantage of the Internet to distribute proxy materials, and at least one company has broadcast its annual meetings over the Internet. John C. Wilcox, *Electronic Communication and Proxy Voting: The Governance Implications of Shareholders in Cyberspace*, Insights, March 1997, at 9, 10. Electronic proxy solicitation over the Internet has led to concerns regarding notice of delivery, access to information, and evidence of delivery. The SEC has indicated that delivery to an investor's e-mail account was equivalent to sending information through the normal mails, but that information placed on a web page would require a separate, more direct notice of availability of the information, such as through some type of prompting mechanism. *See October 1995 Release* at *16. Specifically, the SEC stated that an investor should be able to download or print electronic documents and that they should not be any more burdensome to read than paper ones. *See id.* at *13, *16-*17. In addition to the above SEC requirements, the issuer must be able to confirm that the investor has received, accessed, downloaded, or printed the electronic information through an electronic mail return receipt or a receipt of revocable informed consent from an investor to receive electronic information; otherwise, the company would have to still mail a paper copy to the investor. *See id.* at *19-*20.

• **Mutual Funds.** Investment companies, including mutual funds, have become the primary domain of the individual investor. Over 38 million U.S. investors have invested more that $4.6 trillion in 4,000 investment companies. *Report to Congress*, at 17. Mutual funds have used web sites to provide information about their funds to potential investors and have developed systems for selling shares directly to investors rather than through third parties. The use of such technology gives rise to unique issues under the separate regulatory structure established for mutual funds. One adviser, for example, sought confirmation that portfolio transaction information posted on their web pages would not violate the prohibition, in Rule 206(4)-1(a) under the Investment Advisers Act of 1940, 17 C.F.R. § 275.206(4)-1(a), on the distribution of advertisements referring to specific recommendations by an investment adviser that could have been profitable to any person. In response, the SEC's staff agreed in a no-action letter that such information, in this context, would not constitute an "advertisement" subject to the rule. *See Munder Capital Management*, SEC No-Action Letter, 1996 SEC No-Act. LEXIS 518 (May 17, 1996).

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As with each of these issues, the SEC's position regarding NASDAQ order execution has evolved with the technology available for such transactions. At one point, the duty of best execution could be satisfied by securing three stock quotes over the telephone. *See* Order Execution Obligations, Exchange Act Release No. 36310, 60 Fed. Reg. 52,792, 52,793 (Sept. 29, 1995). Nearly two years after the class period, the Commission, following an extensive comment period, amended its rules, on a prospective basis, to require that prices offered by broker-dealers on "electronic communications networks" - examples of which include Instinet and SelectNet - be incorporated into their quotations on the NASDAQ system. *See* Order Execution Obligations, Exchange Act Release No. 37619A, 61 Fed. Reg. 48,290 (Sept. 12, 1996). While the Commission has acknowledged that, during the class period, execution of

NASDAQ trades at NBBO "was 'generally' viewed as consistent with best execution for order handled on an automated basis,"[7] the Commission later refined that position because "the development of efficient new facilities has altered what broker-dealers must consider in seeking best execution of customer orders."[8] The Third Circuit did not explain how adherence to then-existing regulatory standards could reflect an intent to commit fraud in the context of a marketplace that necessarily must look to the SEC to establish standards for adapting frenetic technological changes.[9]

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[7] SEC Supplemental Brief, *Amicus Curiae* (Nov. 21, 1997) at 2. *See also* Division of Market Regulation, S.E.C., *Market 2000, An Examination of Current Equity Market Developments, at V-5*, 1994 SEC LEXIS 136, at *15 (Jan. 1994) (broker-dealer's use of the NBBO fulfills the duty of best execution).

A blue-ribbon committee, chaired by Former SEC Chairman David S. Ruder, concluded in 1991 that "when orders are executed at the best current displayed bid or offer that investors receive best execution of their small-sized orders regardless of the order-routing arrangements practiced by their brokers." David S. Ruder et al., *Inducements for Order-Flow, A Report to the NASD Board of Governors*, July 1991, at 26. The committee further concluded that, "the SEC, in approving the operations and regulatory requirements of SRO-sponsored and independent automated systems that execute orders at the best published price, appears to have recognized that, in automated executed systems, matching the best displayed bid or offer satisfies the standard for best execution for small-sized orders." *Id.*

[8] Order Execution Obligations, 61 Fed. Reg. at 48,322-23.

[9] For more than two decades, this Court has required that conduct actionable under Section 10(b), and Rule 10b-5, involve "scienter" or "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)

C. An Expert Agency is Uniquely Suited to Adapt the Regulatory Structure to Changes in Information Technology

The District Court below declined "to retroactively second-guess the SEC." *In re Merrill Lynch Sec. Litig.*, 911 F. Supp. at 774. The Third Circuit's *en banc* decision accepted that invitation by suggesting that, because two services - Instinet and SelectNet - were available during the class period, "a trier of fact could infer that the defendants' acceptance of the orders was reasonably understood as a representation that they would not be executed at NBBO price when better prices were reasonably available elsewhere." *Newton*, 135 F.3d at 266. A marketplace executing in excess of 1.6 billion transactions annually cannot allocate its obligations on what a trier of fact subsequently "could infer."

This Court has long recognized that Congress established expert agencies to regulate highly complex and technical areas; thus, following Congress's will, this Court frequently defers to an agency's interpretation of its governing statutes and rules because the agency's knowledge and expertise is superior to that of the judiciary in the area of law the agency is charged with enforcing. *See, e.g., Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 845 (1986). This deference is a product both of an awareness of the practical expertise which an agency normally develops, and of a willingness to accord some measure of flexibility to such an agency as it encounters new and unforeseen problems over time." *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 566 n.20 (1979).

In the securities arena, Congress repeatedly has recognized the critical nature of the SEC's guidance and the public's need to rely on such guidance. For example, Section 23(a)(1) of the Exchange Act, 15 U.S.C. § 78w(a)(1), provides that no liability shall attach "to any act done or omitted in good faith in conformity with a rule, regulation, or order of the

Commission." Similarly, Congress specifically recognized the need for the SEC's interpretation of technology issues in enacting the National Securities Market Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416. Under this statute, the SEC was required to report on the impact of technological advances on the securities markets. The SEC's response acknowledged the agency plays an important role in guiding market participants in how to abide lawfully by the securities laws while at the same time taking advantage of technological innovations. *See Report to Congress*, at 1 ("The Commission is mindful of the benefits of increasing use of technology . . . and has encouraged experimentation and innovation by adopting flexible interpretations of federal securities laws.").

The most pernicious aspect of the Third Circuit's ruling is that it usurps the rulemaking function specifically entrusted to the Commission by Congress. As outlined above, the SEC continues to adapt its regulatory requirements to a marketplace that must accommodate continually changing technological capabilities. Marketplace participants must rely on that guidance for a measure of certainty in their activities. The Third Circuit's opinion, at the behest of private litigants, reassesses regulatory standards for the 1992-94 class period – without the procedural protections that accompany SEC rulemaking.

In granting summary judgment in this case, the District Court recognized that Congress had conferred regulatory power upon the SEC, not the judiciary, to oversee the nation's securities markets. "It is inappropriate for courts to interfere with that mandate except under extraordinary circumstances." *In re Merrill Lynch Sec. Litig.*, 911 F. Supp. at 773. The Third Circuit's *en banc* decision would facilitate the second-guessing of a decision made by an expert agency – in this case and others. This Court, appropriately, has discouraged such reviews.

III. THE BREADTH OF THE THIRD CIRCUIT'S OPINION CONFLICTS WITH RULINGS OF THIS COURT THAT SECTION 10(b) CAPTURES ONLY FRAUD

The sweeping *en banc* decision is distinctive in the breadth of its interpretation of Section 10(b). The Third Circuit recognized the novelty of its decision, noting that "the practice of exclusive reliance on the NBBO *has never been held to be fraudulent by any court or regulator*." *Newton*, 135 F.3d at 774 (emphasis supplied). Left unexplained was just how reliance on a universal system for quoting prices could constitute a fraud under Section 10(b) when - as the SEC noted before the Third Circuit - no alternative system was mandated during the class period. *See* SEC Supplemental Brief, *Amicus Curiae* (Nov. 21, 1997) at 6-7; SEC Brief, *Amicus Curiae* (Oct. 17, 1996) at 10-12.

This reading of Section 10(b) is not only at odds with this Court's concern with certainty and predictability as discussed above, but also with this Court's rejection of expansive interpretations of Section 10(b). *See, e.g., United States v. O'Hagan*, 117 S. Ct. 2199, 2213 (1997) (noting that this Court has confined the Section 10(b) private right of action); *Ernst & Ernst*, 425 U.S. at 214 (rejecting expansive reading of 10(b) by holding that intent is a basic element of every broker misconduct claim); *Santa Fe Indus. v. Green*, 430 U.S. 462, 478-79 (1977) (a violation under the statute or rule can occur only if the conduct at issue involves manipulation or deception); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 754-55 (1974) (construing Section 10(b) and Rule 10b-5 to require plaintiff to be purchaser or seller of securities in question).

The Third Circuit's expansive decision here conflicts with a recent Fourth Circuit decision concerning, among other things, allegedly excessive markups and Section 10(b). *Banca Cremi*, 132 F.3d at 1034-35. In *Banca Cremi*, the Fourth Circuit affirmed the grant of summary judgment to the defendant securities broker, even though plaintiff's expert had testified that

his examination had shown that all of the markups at issue were excessive. *Id.* at 1034-35. Like the respondents here, plaintiff in *Banca Cremi* had argued that "securities dealers have an inferred duty to disclose certain markups, despite the SEC's specific decision not to require such disclosures through regulations." *Id.* In rejecting that argument, the *Banca Cremi* Court noted it was "acutely uncomfortable," with the proposition that, in the absence of any SEC regulation prohibiting such conduct, the issue of whether excessive markups had occurred could be put to a jury simply based on the opinion of a paid expert after the fact. *Id.*

Amici share that discomfort with respect to the Third Circuit's opinion below. In a business environment in which the available information technology is evolving at a frenetic pace, it will always be possible to contend that the latest innovation made additional steps "feasible." A burgeoning market cannot order its obligations around a jury's *post hoc* determination about just how far a legal standard had evolved based on the technology then available. Market participants must be able to rely on existing regulatory guidance in structuring their affairs. Left intact, the Third Circuit's opinion undermines this reliance and the certainty that is critical to our capital markets.

CONCLUSION

For all the foregoing reasons, this Court should grant the Petition for a Writ of Certiorari.

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